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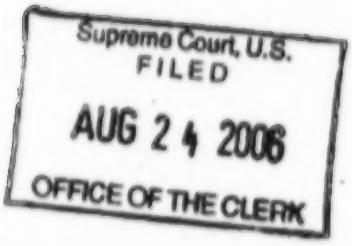

No. 05-381

IN THE

Supreme Court of the United States

WEYERHAEUSER COMPANY,

Petitioner,

v.

ROSS-SIMMONS HARDWOOD LUMBER CO., INC.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF ECONOMISTS AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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Amici respectfully submit this brief pursuant to Supreme Court Rule 37.3 in support of Petitioners.[1] We urge the Court to reverse the judgment of the United States Court of Appeals for the Ninth Circuit.

INTEREST OF *AMICI CURIAE*

Amici curiae are economists who teach at leading universities throughout the United States. *Amici* have written extensively in the field of economics, including industrial organization, competition, and antitrust economics and policy. *See* Appendix, List of *Amici Curiae*. *Amici* seek to bring to the Court's attention economic analysis relevant to the question of the proper standard for antitrust liability for alleged predatory buying. *Amici* believe that the Court of Appeals for the Ninth Circuit set forth a test that is wrong as a matter of economic theory which, if implemented, will result in adverse economic consequences. For those reasons, *amici* believe the decision of the Ninth Circuit should be reversed.

SUMMARY OF ARGUMENT

This case presents significant questions about the proper standard for determining when an increase in the price paid for supplies or an increase in the amount of supplies purchased by a single firm, acting independently, constitutes predatory buying in violation of antitrust laws. The Court of Appeals rejected the standard used when predatory *selling* is alleged, as set forth in this Court's decision in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). Instead, the Court of Appeals concluded that a purchaser of supplies can violate the antitrust laws by paying

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[1] Pursuant to Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part, and no person or entity other than the Analysis Group has made a monetary contribution to the preparation or submission of this brief. All parties have consented to the filing of this brief *amici curiae*, and their consent letters are on file with the Clerk's Office.

a "higher price . . . than necessary" or by purchasing more inputs "than ... needed," if that prevents other buyers from obtaining the "[inputs] they needed at a fair price." *Confederated Tribes of Siletz Indians v. Weyerhaeuser Corp.*, 411 F.3d 1030, 1037, 1040 n.30 (9th Cir. 2005). These phrases, however, fail to take into account the procompetitive reasons a firm might increase the price it pays for supplies or increase the amount of supplies it purchases. Nor do they take into account the consumer benefit of a price reduction for the finished product which generally results when increased prices are paid for supplies. Moreover, these phrases offer no basis for distinguishing between permissible and impermissible business conduct.

Amici believe that the *Brooke Group* two-pronged standard for predatory *selling* should be applied to allegations of predatory *buying*. That standard, which looks at both cost and the likelihood of recoupment of losses incurred by virtue of predatory conduct, is consistent with economic theory. As a result, *amici* believe the decision below should be reversed.

ARGUMENT

Economists generally applaud the Supreme Court's recognition that the antitrust laws are designed for the "protection of competition, not competitors." *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962). This important phrase means that the antitrust laws should promote an economic environment of free competition and deter anticompetitive business conduct that raises price and restricts output. The laws must be applied in such a way that antitrust enforcement does not reduce competitive vigor either in the short run or the long run.

Thus, the Supreme Court repeatedly has cautioned against reading the antitrust laws too expansively where the conduct of a single firm, acting independently, is at issue. *See, e.g., Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, L.L.P.*, 540 U.S. 398, 408 (2004). This Court likewise has

cautioned against judicial interference with prices set in the market. "[Courts] must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986) (internal quotation marks omitted).

Nonetheless, and contrary to those warnings, the Court of Appeals for the Ninth Circuit concluded that a purchaser of supplies—what economists call "inputs"—can violate the antitrust laws by paying a "higher price . . . than necessary" or by purchasing more inputs "than ... needed," if that prevents other buyers from obtaining the "[inputs] they needed at a fair price." *Confederated Tribes of Siletz ~~Indians~~ v. Weyerhaeuser Corp.*, 411 F.3d 1030, 1037, 1040 n.30 (9th Cir. 2005). Higher "than necessary," more "than ... needed," and "a fair price" are expressions devoid of analytical or economic content. They do not measure economic performance against a specific benchmark, and offer no reasonable guidance as to permissible (or impermissible) business conduct. Their meaning is so vague that the effect of the court's holding will be to protect competitors at the expense of consumers and the competitive process itself. For these reasons, the decision of the Court of Appeals should be reversed.

I. THE NINTH CIRCUIT'S STANDARD FOR PREDATORY BUYING IS UNSOUND AS A MATTER OF ECONOMICS

An investment in predatory *selling* involves a short-term profit-sacrifice (by charging below-cost prices and selling more output) with the expectation of recouping the lost profits with monopoly profits in the future. The below-cost pricing prong of *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993), is used to evaluate the existence of this profit-sacrifice in the case of predatory

pricing by a seller. A "dangerous probability ... of recoup[ment]" on the part of a predatory seller, as the Supreme Court acknowledged in *Brooke Group*, is the second prong that distinguishes legitimate pricing behavior from anticompetitive conduct. *Id.* at 224.

This two-pronged approach is important because there are numerous competitive reasons why sellers might reduce their prices, and price cuts benefit consumers. Predation and consumer harm only can occur if losses incurred through below-cost pricing subsequently are recouped with monopoly prices and profits. Without a "dangerous probability of recoupment," it is unlikely that the benefits to consumers from the price reductions would be outweighed by consumer harm due to monopoly prices. As a result, in the absence of recoupment where predatory *selling* is concerned, this Court has held that there can be no Sherman Act violation. *Id.*[2]

This same economic analysis applies to the conduct of *buyers*, the issue in this case. Predatory buying also can be viewed as an investment by a firm: lower (or negative) profits now, in return for higher profits in the future. *See Matsushita*, 475 U.S. at 588-89.[3] An investment in predatory

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[2] "The message in *Brooke Group* is that predation cases, to be successfully tried, must show that recoupment is feasible. The Areeda-Turner test remains a useful screening device: showing that an alleged predator sustained losses during a short-run period of below-cost pricing. But success now requires evidence that the below-cost pricing episode will be worth the candle. A plaintiff must show that the alleged predator is able to recoup its losses by exercising monopoly power." Kenneth G. Elzinga & David E. Mills, *Trumping the Areeda-Turner Test: The Recoupment Standard in Brooke Group*, 62 ANTITRUST L.J. 559, 583 (1994).

[3] *See, e.g.*, Kenneth G. Elzinga & David E. Mills, *Testing for Predation: Is Recoupment Feasible?*, 34 ANTITRUST BULL. 869 (1989) (cited in *Brooke Group*, 509 U.S. at 226); Roger D. Blair & Jeffrey L. Harrison, MONOPSONY 67 (1993) ("[T]he buyer must be able to 'profit' from the

buying involves a short-term profit-sacrifice due to paying higher input prices and increasing the amount of input purchases, with the expectation of recouping the lost profits with either monopsony or monopoly profits in the future.[4] Put briefly, the buyer strategically overpays and buys more inputs, initially sacrificing profits as a result. A profit-sacrifice arises when the input purchases do not generate incremental revenues in excess of their incremental costs.[5] In the absence of a showing of profit-sacrifice and the likelihood for recoupment, there is no assurance that the defendant is engaged in predatory buying rather than simply engaging in vigorous competition as a buyer in an input market.

The only difference between predatory buying and selling, from an economics perspective, is that the roles of buyers and sellers are reversed. Just as there are legitimate reasons why a *seller* might reduce prices, so too, there are procompetitive (or economically benign) reasons why a *buyer* might pay a higher price than previously for an important input and increase the amount of purchases. *See infra* pp. 9-11. That is why, unless there is a realistic prospect of recoupment in the future, sacrificing profits in the short run by paying a higher

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lower price for a long enough period of time that it can make up its predatory 'investment.'").

[4] "[P]ure monopsony entails a single buyer. It is the demand-side analog to the monopolist who is a single seller." Roger D. Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 CORNELL L. REV. 297, 300 (1991).

[5] Purchasing inputs that are not used, in order to raise the input price paid by competitors, also would involve sacrifice because those inputs would not generate any revenue. Of course, a firm may be left with unused inputs if demand for its product unexpectedly declined.

input price "than necessary" or buying more inputs "than ... needed" would have no anticompetitive effect.

The Court of Appeals ostensibly recognized that a successful predatory buying scheme requires the ability to "recoup the higher costs [the predator] had paid for its materials." 411 F.3d at 1038. Nonetheless, the court proceeded to approve a jury verdict based on instructions that not only failed to require a showing of likely recoupment but did not even mention the concept. This is economic error and has potentially serious consequences for antitrust policy down the road.

There are two possible ways for an alleged buyer-side predator to achieve anticompetitive recoupment: *First*, the buyer could pay a lower monopsonistic price for the inputs during the recoupment period, having "overpaid" in the initial predatory period. This strategy is the mirror image of predatory pricing on the seller side. For the strategy to succeed, other efficient input market competitors and new entrants must be unable to take advantage of the artificially low input prices and expand their purchases. In this case, it is our understanding that many firms continued to compete with Weyerhaeuser, and four firms—all alternative buyers—*entered* the sawmill business during the period of the alleged violation. These facts demonstrate that the higher input price was affordable to efficient saw mills, and that there were not insurmountable barriers to entry.

Second, the buyer could charge higher monopolistic prices for its output.[6] This recoupment strategy is not a mirror

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[6] In this second kind of recoupment situation, the firm increases its competitors' costs, but does not necessarily eliminate its rivals from the output market. If the firm achieves monopoly power in the output market, then it could recoup its exclusionary investment with higher output prices and monopoly profits, even if its competitors do not exit. This recoupment, involving monopoly power in the downstream output market, avoids the short-term consumer benefits, time lag, and uncertainty that

image of predatory pricing on the seller side. For Weyerhaeuser, this strategy would have entailed selling finished lumber at monopoly prices. However, it is our understanding that the jury found that Weyerhaeuser accounted for less than 3% of hardwood lumber sales, and lacked market power in the downstream lumber market. Thus, Weyerhaeuser could not charge supra-competitive prices for its output and lacked any recoupment prospect in the output market.

The decision of the Court of Appeals fails to take into account these economic realities, just as it fails to acknowledge that predatory buying schemes to achieve monopsony power are like predatory pricing schemes in that they are rare, and even more rarely successful.[7] The Court of Appeals also fails in another significant respect. While the court acknowledged that in *seller*-side predation, consumers benefit from the lower prices, at least in the short run, it did not seem to appreciate the value of the same consumer benefit where *buyer*-side predation is concerned. A higher input price generally will end up encouraging more input supplies, leading to greater output and a resulting reduction of prices to consumers in downstream markets.

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arise where recoupment related to future monopsony power in the input market is sought. *See* Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 ANTITRUST L.J. 669, 671, 679-82 (2005). This strategy raises more serious anticompetitive concerns. As a result, the antitrust standard for this kind of conduct, not relevant to this case, may be different than the one applicable here. *Id.* at 704-06.

[7] *See Matsushita*, 475 U.S. at 589 ("[T]here is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful.").

In this situation, for example, a higher input price presumably would encourage some suppliers to offer to sell sawlogs during the predatory period that they otherwise would have withheld from the market. The Court of Appeals concluded instead that "[t]he nature of the input supply at issue here does not readily allow for market expansion" because the market for alder sawlogs is "relatively inelastic." 411 F.3d at 1038 (citing Richard O. Zerbe, Jr., *Monopsony and the Ross-Simmons Case: A Comment on Salop and Kirkwood*, 72 ANTITRUST L.J. 717, 722 (2005)).

Supply elasticity is a key concept in analyzing this case. "Economists define the price elasticity of supply as the responsiveness of the quantity supplied of a good to its market price." Paul A. Samuelson & William D. Nordhaus, ECONOMICS 70 (16th ed. 1998). Only if supply is totally unresponsive to price—what economists call *perfectly inelastic*—will the same quantity be supplied when price rises. In contrast, if the supply of the sawlog market is less than perfectly inelastic, for example, if it is only "relatively inelastic," there will be some increase in the quantity supplied when price rises, and that increased supply will cause lumber production to increase and consumers to benefit. The court discounted the relevance of the increased supply and consumer benefits, acknowledging that "consumers might temporarily benefit," but going on to say that "a reduction in prices would place even greater pressure on competitors, thereby increasing the threat to competition arising from the predatory bidding." 411 F.3d at 1038.

As a result, the court's decision manages to fall off the horse on both sides: undervaluing the benefits of the freedom to make unilateral pricing decisions without significant antitrust constraints, and overprotecting competitors at the likely expense of competition and consumers. The creation of such an incorrect constraint on competition for inputs is likely to have both short-term and long-term adverse effects

on the efficient operation of input and output markets, and thus on suppliers and consumers.

Price is an important market signal—the "central nervous system of the economy," *National Society of Professional Engineers v. United States*, 435 U.S. 679, 692 (1978) (internal quotation marks omitted)—and facilitates the efficient allocation of resources in free markets.[8] Whether the issue is the price paid to suppliers for an input or the price charged to consumers for an output, impeding price signals threatens market efficiency. The Ninth Circuit ignored these efficiency benefits. Instead, it concluded that simply paying more "than necessary" or buying more inputs "than needed" or denying competitors the ability to buy inputs at a "fair price" by some undisclosed standard is sufficient support for finding a violation of the antitrust laws. 411 F.3d at 1037, 1040 n.30. This approach is an economic setback for antitrust.

II. THERE ARE PROCOMPETITIVE REASONS WHY A PRODUCER MIGHT PURCHASE MORE INPUTS AND RAISE THE PRICE PAID FOR INPUTS

In holding that Weyerhaeuser could be found to have violated the Sherman Act if it "paid a higher price for logs than necessary," *id.*, the Ninth Circuit failed to acknowledge or even consider *procompetitive* reasons why a firm might

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[8] "Market prices provide producers with up-to-date information about which goods consumers most intensely desire, and with important information about the abundance of the resources used in the production process. ... Market prices also coordinate the choices of buyers and sellers, bringing their decisions into line with each other." James D. Gwartney, Richard L. Stroup, Russell S. Sobel & David A. Macpherson, ECONOMICS: PRIVATE AND PUBLIC CHOICE 79 (11th ed. 2006). *See also* Samuelson & Nordhaus, *supra*, at 27 ("Prices are the balance wheel of the market mechanism.").

increase its input purchases and pay an elevated price for inputs.

First, a more efficient production process could lead to an increase in input price. The opportunity to exploit efficiencies could lead a firm to expand production and seek more inputs, resulting in an increase in the market price for inputs. When one firm is more efficient than its competitors, the price it is willing or able to pay for inputs simply "reflects the lower cost structure of the alleged predator, and so represents competition on the merits." *See Brooke Group*, 509 U.S. at 223.

Second, a firm might increase the price it is willing to pay for inputs and purchase more inputs when its capacity has expanded in response to increased efficiency or demand. To illustrate, it appears that Weyerhaeuser invested nearly $80 million in infrastructure improvements between 1986 and 2000, and that during the same time period, Weyerhaeuser's alder production at its Longview mill more than doubled.

Third, a firm might pay more for an input that is of higher quality. For example, it is our understanding that like many woods, alder has a variety of uses, depending on its quality. A higher price paid for alder logs could result in obtaining higher grade logs from existing or new suppliers, enabling a firm better to compete in the overall hardwood lumber market.

Fourth, a firm might find that paying more for an input actually produces cost-saving efficiencies. A mill might, for example, pay more for logs in order to guarantee a steady supply of logs when demand volatility increases or interest rates fall. Keeping production levels uniform enables equipment capable of processing a high volume of logs to remain in operation and thereby reduce labor costs. Thus, it may be economically rational for a mill to increase its inventory levels to avoid the likelihood of running out of sawlogs to process.

Finally, a business might increase its input purchases and the price it is willing to pay for inputs as a result of a change in business strategy. A business might, for example, seek to increase market share in the downstream market, a wholly legitimate goal under the antitrust laws. *See Cargill, Inc. v. Monfort of Colo., Inc.*, 479 U.S. 104, 116 (1986) ("[C]ompetition for increased market share ... is not activity forbidden by the antitrust laws. It is simply . . . vigorous competition."). With respect to the lumber industry, a mill could pay more to acquire more logs, produce more lumber, and then sell its lumber at the same or reduced prices in order to expand its relative position in the market.

There are many procompetitive reasons why a firm might pay an elevated price for inputs and increase its input purchases. It is essential that antitrust liability attaches only if there is reliable evidence that the likely effect of an increase in input costs and purchases is anticompetitive. *Matsushita*, 475 U.S. at 587.

III. THE STANDARD FOR ANTITRUST LIABILITY FOR PREDATORY BIDDING STRATEGIES SHOULD BE OBJECTIVE AND SHOULD AVOID DETERRING COMPETITION

Given these complexities, it is neither appropriate nor feasible simply to ask a jury to determine whether a firm bought more than it "needed" or paid more than "necessary." 411 F.3d at 1040 n.30. These are portmanteau expressions that cannot be unpacked analytically, standardless words with no basis in economic reasoning. In light of the potential harm in allowing courts and juries to wander in this area without guidance, the reasons that led this Court to issue a narrow and tailored rule for predatory selling in *Brooke Group* should lead to the same conclusion for predatory buying. Input prices or purchases should be labeled "predatory" only if the cost of the inputs exceeds the revenues they generate, and there is a realistic expectation—or in the parlance of antitrust

law, a "dangerous probability"—that the scheme could be successfully implemented and consumers harmed through some form of future recoupment.[9] Because the Court of Appeals' decision does not credit these critical requirements, it should be reversed.

The Ninth Circuit failed to recognize that paying a high input price and increasing input purchases generally will be "as consistent with permissible competition as with illegal [conduct]," and thus cannot "standing alone, support an inference of antitrust [violations]," *Matsushita*, 475 U.S. at 588, even if it harms a rival. In this context, the Court of Appeals erred in concluding that the prophylactic rule of *Brooke Group* should not be applied to predatory buying claims. As a result, the court fashioned a rule "that authorizes a search for a particular type of undesirable pricing behavior [and] end[s] up [] discouraging legitimate price competition." *Id.* at 594 (internal quotation marks omitted). This case thus illustrates the kind of false positive that is a probable outcome

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[9] *See* Donald J. Boudreaux, Kenneth G. Elzinga & David E. Mills, *The Supreme Court's Predation Odyssey: From Fruit Pies to Cigarettes*, 4 SUP. CT. ECON. REV. 57, 63 (1995) ("To avoid unnecessary stifling of competition, as well as to discourage rent-seekers from using antitrust to pursue their narrow self-interests, antitrust law should proscribe only flagrantly anticompetitive behaviors, confident that the law of property, contract, and tort, on one hand, and the forces of profit-seeking, on the other, will generally protect consumers from severe long-term harm."); William J. Baumol & Janusz A. Ordover, *Use of Antitrust to Subvert Competition*, 28 J. LAW & ECON. 247, 254 (1985) ("The potential defendant who cannot judge in advance with any reasonable degree of certainty whether its behavior will afterward be deemed illegal is particularly vulnerable to guerilla warfare and intimidation into the sort of gentlemanly competitive behavior that is the antithesis of true competition.").

of applying the unbounded and vague legal standard approved by the Court of Appeals.[10]

Although the Ninth Circuit's analysis is not entirely clear, Weyerhaeuser could not recoup its alleged profit-sacrifice and harm consumers. There was continued competition on the buyer-side of the market from new entrants and existing rivals. In addition, Weyerhaeuser lacked market power in the finished lumber market and so could not charge supracompetitive prices to consumers in the output market. Thus, no harm to competition could occur, and any harm to competitors is not a concern of the antitrust laws.

The Ninth Circuit rule requires judges and juries to make highly subjective determinations regarding the propriety of upward price adjustments for inputs, effectively requiring judges and juries to review pricing decisions without providing any objective criteria against which prices can be assessed. "To set the jury adrift on uncharted seas—and then to defer to whatever it does—is to introduce considerable risk into all business decisions." Frank H. Easterbrook, *On Identifying Exclusionary Conduct*, 61 NOTRE DAME L. REV. 972, 979 (1986).

Permitting the Court of Appeals' decision to stand will have adverse consequences on economic behavior. In particular, by leaving firms unable to evaluate the consequences of their pricing conduct, it will constrain competition and introduce inefficiencies that could lead to higher consumer prices. Courts should be reluctant to interfere in the price setting function, and they have been, as *Brooke Group* illustrates. That same economic caution and judicial humility should have been applied here. Because it

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[10] "[S]ince documented cases of predatory pricing are rare, a test not disposed to false positives is superior to one equally indisposed to false negatives. Consumers will be afforded more opportunities to secure the benefits of price competition." Elzinga & Mills, *Trumping*, *supra*, at 562.

was not, the decision of the Court of Appeals should be reversed.

CONCLUSION

The Ninth Circuit's decision should be reversed.

Respectfully submitted,

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APPENDIX

APPENDIX

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William J. Baumol, Ph.D, Academic Director, and Harold Price Professor of Entrepreneurship, Berkley Center for Entrepreneurial Studies, Stern School of Business, New York University. Professor Baumol has written extensively on industrial organization, antitrust economics and policy including predation and regulation, microeconomics, and macroeconomics. He is a senior economist and professor emeritus at Princeton University, and past president of the American Economic Association. Professor Baumol earned his Ph.D from the University of London.

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